Supreme Court of the United States

OCTOBER TERM, 1941.

No.....

HENRY A. B. DUNNING,
Petitioner,

vs.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,
Respondent.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

I. Opinions Below.

The opinion of the Board of Tax Appeals is reported in 41 BTA 1101. (R. 9-22) The opinion of the Circuit Court of Appeals of the Fourth Circuit is reported in 118 F.2 341. (March 10, 1941) (R. 68-79)

II. Jurisdiction.

The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended (28 USCA Sec. 347).

III. Statement of the Case.

See Heading I of the Petition for Certiorari, above, "Statement of the Matter Involved".

IV. Specification of Errors.

The Circuit Court of Appeals erred:

1. In holding taxpayer taxable on the income here involved.
2. In construing Sec. 166 so as to tax the income of the taxpayer.
3. In holding that Sec. 166, as construed by the Circuit Court of Appeals, does not deprive taxpayer of his property in violation of the due process of law clause of the United States Constitution, Article of Amendment No. V.
4. In holding the taxpayer taxable under Helvering v. Wood, 309 U. S. 344, and Du Pont v. Commissioner, 289 U. S. 685.
5. In reversing the decision of the Board of Tax Appeals.

V. Summary of Argument.

Petitioner contends,

1. The decision of the lower Court is in direct conflict with Helvering v. Wood, 309 U. S. 344.
2. Section 166 of the Revenue Act of 1934, as construed by the lower Court, levies a tax on Mr. Dunning measured by the income of Mrs. Dunning, but due process prohibits Congress from stamping her income as his to render it taxable against him.

VI. ARGUMENT.

Point 1.

THE DECISION OF THE LOWER COURT IS IN DIRECT CONFLICT WITH HELVERING V. WOOD, 309 U. S. 344.

Under the Dunning trusts, the three adult children, the wife, and the minor child each had a fixed estate for four years and ten months. Dunning had no discretion to shorten, to recall to himself, to abbreviate, or to lessen that fixed estate. Its principal and income alike were untouchable by him for nearly five years.

Dunning did acquire, under the instruments, a right to determine whether the trusts should last after January 10, 1937, but if he died before 1937, the trusts had to last longer. On December 29, 1936, he elected that the trusts should terminate January 10, 1937. The corpus returned to him in 1937. But in 1934, or 1935, or 1936 (for the year 1936) he was completely powerless. No act of his could have caused trust corpus or income for said years to return to him, by way of revesting or by way of reverter.

In 1937 the corpus returned to Dunning by way of reverter, for the residue after the end of the particular estate came back, to the original owner, by operation of law.

In this case the lower Court has held, in effect, that because Dunning might have lengthened the particular estate (though he could not shorten it), it follows that the return of the residue over and above the particular estate has come back to him, not by reverter, but by the exercise of a power vested in him in 1934 to revest the same in himself.

The Commissioner does not contend that Dunning, under the Maryland law, could have revoked this trust before the end of the term. The Dunning trusts had no collapsible features whatever. A rubber band, having a minimum circumference fixed at the factory, may expect to find itself stretched in the hands of the buyer.

In the Wood case, involving 1934 income under Section 166, the original trust was due to expire in 1934, but had been extended in 1932 so as to run on until 1936. In substance a new trust of 1932 was created for a four year term, subject to earlier termination by the death of the grantor or of his wife before 1936.

In the Wood case, when the cestui wife's estate for years was over—and the grantor had fixed that time as 1936—"all property then held in trust" was to be transferred and delivered (37 BTA 1065) to the grantor.

The Board held that the grantor was not taxable—"The petitioner did not own that income nor did it remain his in substance, for, under the terms of the grant and for the specified period of time, the beneficiary had the unfettered right to receive and use the income from the trust corpus." The Second Circuit affirmed (104 F.2 1013) on the authority of *United States v. First National Bank of Birmingham* (CCA5), 74 F2d 360. This Court held that this corpus was due to return to him by way of reverter, and not by way of revesting.

Mr. Justice Douglas says:

> "Our difficulty lies not in an inability to see the similarity of those situations but in being able to say that Congress treated them the same under §166. A power to revest or revoke may in economic fact be the equivalent of a reversion. But at least in the

law of estates they are by no means synonymous. For, generally speaking, the power to revest or to revoke an existing estate is discretionary with the donor; a reversion is the residue left in the grantor on determination of a particular estate. See Tiffany, Real Property (2nd ed.) §129 *et seq.*, §316 *et seq.* Congress seems to have drawn §166 with that distinction in mind, for mere reversions are not specifically mentioned. Whether as a matter of policy such nice distinctions should be perpetuated in a tax law by selecting one type of trust but not the other for special treatment is not for us. We have only the responsibility of carrying out the Congressional mandate. And where Congress has drawn a distinction, however nice, it is not proper for us to obliterate it. That seems to us to be the case here. Whether wisely or not, Congress confined §166 to trusts where there was a 'power to revest.'"

The Court pointed out that in 1934 the Treasury had recommended that "the income from short-term trusts and trusts which are revocable by the creator at the expiration of a short period after notice by him should be made taxable to the creator of the trust", but that Congress adopted only the latter suggestion.

The whole purpose of the amendment of 1934 was to render taxable the trust which could be revoked at the end of *a short period after notice given by the grantor.* In this trust the income of 1937 is taxable to the grantor in spite of the fact that the notice was not given in 1937 (that is, during the taxable year) but was given in December of 1936. The aim of the Amendment was to render taxable the so-called year-and-a-day trusts. Under the old law, the income of 1937 would have escaped taxation because the notice was not given in 1937. The purpose of the amendment was to tax the income

of 1937 even though the notice was given a short period before the taxable year (that is, was given in 1936).*

But none of this bears upon the Dunning trust any more than this Court thought that it bore upon the trust of Meredith Wood. "When such clear choice of ideas has been made in the drafting of a specific provision of the law, its language must be taken at its face value. Section 166 is therefore not applicable to this trust since respondent is given no power to recall the corpus. He or his estate gets it at the end of the term, on the death of his wife, or on his own death—whichever is the earliest" (348). Indeed, in the Dunning trusts the case is stronger, for the untimely death of Dunning would have had the effect of prolonging the term of the trusts to the outside limit of time of the rule against perpetuities.

Dunning, under these trusts, was given no power to recall the corpus; it reverted to him by condition subsequent. The trusts, in terms, were "*irrevocable in all respects* until January 10, 1937."

> "This deed of trust shall continue in full force and effect *irrevocable in all respects* until January 10, 1937, and, subject to the exceptions hereinafter stated, shall terminate on that date, if Henry A. B. Dunning, by written notice to his co-trustee on or before December 31, 1936, declares that he desires no extension of said date of termination. If no such notice is given the above date of January 10, 1937, shall automatically be extended to January 10, 1942, and thereafter during the life of Henry A. B. Dunning from time to time the date of termination shall be automatically extended for successive periods of five years each if no notice as above specified be

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NOTE *—As in *Kraft v. Commissioner* (CCA3), 111 F2d 370, where taxpayer retained the power to repossess the corpus by notice given 5 days before the end of any calendar year, including 1933.

given ten days before the end of any current five year period. Upon any termination of the trust the corpus of the estate (but not the accumulated income) shall revert to Henry A. B. Dunning, to be his absolutely." (R. 41)

The majority in the Court below take the position that Dunning had, in 1934, a vested power to revest the corpus as of 1937, subject to be divested in the event of his death prior to 1937.

But this view, it is submitted, is at variance with the nature of the estate created, with the nature of powers, and with the distinction between reverter and revesting, adopted by Congress and recognized by this Court.

Under these trust provisions the Trustees had, at least, an estate for years for a minimum term of four years and ten months. More strictly, the Trustees had a vested estate for the life of Dunning, subject to be divested down to the minimum term of four years and ten months by the act of Dunning if Dunning lived to 1937, and down to a term of nine years and ten months, if Dunning lived to 1942, and so on in five year stages.

2 *Blackstone Comm.*, 121.
McArthur v. Scott, 113 U. S. 340, 28 L. Ed. 1015, 1026.
Curry v. McCanless, 307 U. S. 357, 380.

Viewing the interest of the Trustees at the minimum, that is, as an estate for years, the non-taxability of the income to the grantor is convincingly stated in *U. S. v. First National Bank of Birmingham* (CCA1), 74 F2d 360. This case was decided by the Circuit Court of Appeals, First Circuit, December 18, 1934. The trust instrument conveyed realty for an ascertained period fixed in ad-

vance, the income to be used during that period for educational purposes. The income was held not taxable to the settlor of the trust. The Court said:

> "By that instrument the entire property rights in the described real estate for the period stated were irrevocably vested in the grantee, the estate granted being one limited to endure for a definite and ascertained period fixed in advance is what is known as an estate for years. * * * The corpus of the trust was the granted estate in the described property for the stated period. The income from that property during that period was the grantee's income, not the grantor's income, as it was subject to the unfettered command of the grantee, not subject to any power over it exercisable by the grantor, the source of it being a property interest or estate irrevocably vested in the grantee. * * * The income in question was not taxable against appellee's testator because he did not own that income or have any beneficial interest therein when it accrued, and did not have the power, either alone or in conjunction with any person not a beneficiary of the trust, to revest in himself the title to the property interest or estate which was the source of that income." (362)

The fact that Dunning had a power of any kind vested no estate in him (*United States v. Field*, 255 U. S. 257, 263). Similarly, there is no "power" when the instrument merely makes it possible for a trustee to terminate a trust. (*White vs. Poor*, 296 U. S. 98, 101). The fact that the donee executed (that is, formally exercised) the power did not make the power take effect until the end of the term.

In the case of *Corning v. Commissioner*, 104 F.2d 329 (CCA6), an analysis of the facts will show that the trust could be terminated by the petitioner after the death of

his father, *but in no event prior to 1937.* The question as to whether the power was vested in the grantor to revest in himself, *as of the year 1934,* was therefore an issue in that case, and the Court clearly determined that the rights of ownership in the grantor were not of the vested character which would subject the income of the trust for 1934 to taxation by Congress. The grantor did not have the equivalent of ownership which would make it possible for the act of Congress to fasten upon it. Obviously the statute should be construed to have a meaning within constitutional limitations. The statute could not have meant that the trust was revocable in the year 1934.

The Commissioner may perhaps contend that, while Dunning's right to receive the corpus was contingent on his being alive in 1937, nevertheless the exercise of the power was vested in him in 1934.

The short answer to this is furnished in the Corning case, at 332,

> "The distinction is difficult to apprehend. It is not consonant with generally accepted concepts of powers, for a power which is not presently exercisable and may never be capable of being exercised does not exist. 1 Sugden on Powers, 3d. Am. Ed. 371, 372. It is difficult, therefore, to comprehend that one may be vested with a power that is not presently nor with certainty exerciseable in futuro."
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> *Corning v. Commissioner* (CCA6), 104 F2d. 329, 332.

To which it may be added that Dunning's right to terminate was contingent on the passage of time to 1937 accompanied by his own survival until 1937—a contin-

gency which might never arise. And it cannot be said that Dunning had a power, vested in him in 1934, to recall corpus or income to himself for the period throughout which he had abandoned that income.

Respondent may seek to contend that the lower Court should be sustained on the basis of *Helvering v. Hallock*, 309 U. S. 106, *Helvering v. Clifford*, 309 U. S. 331, *Hormel v. Helvering*, 85 L. ed. 651 or *Hormel v. Richter*, 85 L. ed. 656. But this case rests on Section 166, the rules for which have been laid down in the Wood case. In the cases referred to the trustee's powers were far more far reaching than in the Dunning trusts, (such as the power to shorten with beneficiary's consent, in the Richter case, the power to remove the co-trustee, in the Hormel case, the power to hold trust funds individually and pay or withhold the income, in the Clifford case); the Board of Tax Appeals, the initial finder of fact, has ruled in favor of Dunning in both the 1933 and 1934 cases, and, in the latter instance, the decision was made (May 10, 1940) after consideration of both the Wood and Clifford decisions. (R. 9, 14, 16) Nor is the lower Court's reference to *DuPont v. Commissioner*, 289 U. S. 685, a relevant citation, for the Commissioner was "following the command of Section 219(h)," a statute which, by definition, specifically included trusts whose income "is or may be applied to the payment of premiums on policies," and the trusts in question, by their own terms, came within the statutory definition (see pages 687 and 688).

The issues as to whether Dunning reserved actual control, or command over economic benefits, has been twice decided by the Board of Tax Appeals with respect to these trusts.

In the decision in the 1933 income tax case, the Board said (and the Government accepted the ruling):

> "Since it is concluded that petitioner transferred completely the H. W. and D. stock to the trusts, we do not believe that powers of management of the securities in the trust, or the discretionary power with respect to the sale of trust property, reinvestment of proceeds, or the right to vote the H. W. and D. stock held by the trustees constituted any such reservation of power in the petitioner, as an individual, over the economic benefits or enjoyment of the property such that we should disregard the complete transfer of the stock to the trust and tax the petitioner on dividends and income received by the trust".
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> (36 B. T. A. 1222 at 1227).

In the second Dunning case, 41 B. T. A. 1104, the Board said:

> "The income which the respondent seeks to tax as that of the taxpayer is that of trusts which must be assumed here to be juristic entities, for tax purposes, which the taxpayer did not and could not receive at any time." (R. 13)

The Government in the Dunning case is asking this Court to invent a statute taxing short term trusts.

It is thought, then, that it can be fairly said that the Wood case recognizes (1) that the return of the corpus to the grantor at the end of the term is by reverter,* that is, by operation of law rather than by an interfering predetermining act of the grantor (for, after all, the estate would have reverted to him at the end of the term

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NOTE *—See, recently, Commissioner v. Branch (CCA1), 114 F2d 985, 986, 987.

in the absence of any provision on the subject in the trust,* (2) that Congress recognized the common law distinction in the statute; (3) that the Amendment does not tax 1934 income of a trust whose end may be effected, if at all, for the first time in 1937; (4) that neither Wood nor Dunning, in 1934, was "is vested" with an effective "power" to "revest" in that year; and (5) that a trust for a limited period does not fall within Section 166.**

The Court, in this pending case, does not have before it any issue as to the applicability of Section 22(a) of the Revenue Act. The original letter of the Commissioner, (R. 37) attempting to impose the additional assessment on Dunning, is not based on Section 22(a) and makes no reference thereto; the Board of Tax Appeals was not asked to pass on the point; the Commissioner's brief filed before the Board makes no reference to that section (R. 60-63) and the Circuit Court of Appeals said that its application of Section 166 made it unnecessary for the Court to discuss the doctrine of *Helvering v. Clifford* or the decisions with respect to the Commissioner's right to raise Section 22(a) for the first time on appeal.

Helvering v. Fuller, 310 U. S. 69, 76.

NOTE *—"If one who has an estate in fee simple, on creating a lesser estate in favor of another by conveyance, undertakes expressly to limit, by the same instrument, an estate in fee simple in his own favor, such limitation is nugatory, as being merely a transfer to himself by himself of what he already has. It is an attempt to give to himself as a remainder what he has as a reversion."

Tiffany on Real Prop. (Ed. 1920) Vol. I, Sec. 130.

NOTE **—See Helvering v. Achelis (CCA2), 112 F2d. 929. Note the abandonment by the Government of the contention, in the Richter case (85 L. ed. 656), on stipulated facts, that the trust fell within Section 166—*Commissioner v. Richter* (CCA3), 114 F2d. 452.

2.

SECTION 166, AS CONSTRUED BY THE LOWER COURT, LEVIES A TAX ON MR. DUNNING MEASURED BY THE INCOME OF MRS. DUNNING, BUT DUE PROCESS PROHIBITS CONGRESS FROM STAMPING HER INCOME AS HIS TO RENDER IT TAXABLE AGAINST HIM.

Section 219(g) of the Revenue Act of 1924 was the predecessor of Section 166. It was in 1924 that the Act took the form carrying the words "at any time during the taxable year." In the House the Bill had this form:

> "Where the grantor of a trust reserves a power of revocation which if exercised would revest in him title to the corpus of the trust then the income of such trust shall be included in computing the net income of the grantor."

"At any time during the taxable year" was inserted in the Senate.

The Senate Finance Committee said this:

> "This section provides that when the grantor of a trust reserves the right to change the trust in favor of himself, the income is taxed to the grantor. The subdivision of the House Bill has been rewritten in order that there shall *not* be taxed to the grantor the *income of a trust as to which the grantor has a power of revocation subject however to a condition which has not happened.*" (Italics supplied.)

In 1932 Judge Brewster, in Massachusetts, pointed out, with reference to the change made in the Senate above referred to, that "it was deemed wise to add provisions excepting from the operation of the law income of a trust as to which the grantor's power of revocation was subject to a condition that had not happened." *Lewis v. White*, 56 F.2d 390, 392.

Corliss, in 1922, established a trust under which the grantor "may, from time to time, during the continuance of the trust . . . modify or alter in any manner, or revoke, in whole or in part, this indenture and the trust then existing . . ." Mr. Justice Holmes pointed out, in 1930 (*Corliss v. Bowers*, 281 U. S. 376, at 378), that taxation is concerned with actual command over the property taxed.

With this background, then, of Mr. Justice Holmes' statement in 1930, and with the recognition by Judge Brewster, in 1932, that the power of Congress to tax is concomitant with the power of the grantor to reach and apply the income, the present language of the Amendment of 1934 should be considered.

It is not to be supposed that Congress would enact a statute, headed Revocable Trusts, with the idea of making the income of a trust presently taxable because at some future time (beyond the taxable year) the grantor would reserve to himself the right of revocation. Yet this is precisely what the majority of the lower Court has held. Though Dunning had no command over the income, in 1934, it is said that the statute taxes that income. Thus the grantor is taxed because of income which belonged to his wife.

Mr. Justice Roberts, recognizing that the wife's income is in the fullest degree her separate property and in no sense that of her husband, says

> "that which is not in fact the taxpayer's income cannot be made such by calling it income."
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> *Hoeper v. Tax Commission of Wisconsin*, 284 U. S. 206.

In the Hoeper case the Court had before it a Wisconsin income tax statute which expressly authorized an assessment against the husband of a tax computed on the combined total of his and of his wife's incomes and augmented by surtaxes resulting from the combination. The Court held that the attempt by a state to measure the tax on one person's property or income by reference to the property or income of another was contrary to due process of law as guaranteed by the Fourteenth Amendment.

Reinecke vs. Smith, 289 U. S. 172, 177, shows that it is properly within the power of Congress to draw within the income taxing field and consequently levy a tax upon "a settlor who at every moment retains the power to repossess the corpus and enjoy the income * * *" (177). But the reason why this is allowable is also given, and that reason is because that "settlor has such a measure of control as justifies the imposition of the tax upon him". (177).

In *Dunning v. Commissioner* the taxpayer, throughout the taxing year of 1934, had no power to repossess the corpus and no power to repossess the income.

When the statute commands the levy of a tax on the income of a trust which "is or may be applied" to the payment of insurance premiums, Congress has thereby exercised its legislative judgment in declaring that the trust provisions leave the grantor in a positon equivalent to that of an owner. (*Burnet v. Wells,* 289 U. S. 670, 679, and *DuPont v. Commr.,* 289 U. S. 685, 689). But, as Mr. Justice Cardozo points out in the Wells case (681, 682), "Trusts for the preservation of the policies of insurance involve a continuing exercise by the settlor

of a power to direct the application of the income along predetermined channels. In this they are to be distinguished from trusts where the income of a fund, though payable to wife or kin, may be expended by the beneficiaries without restraint, may be given away or squandered, the founder of the trust doing nothing to impose his will upon the use".

In the Wells case, legislative judgment was that grantor's continuing direction as to how the trust's income was to be applied was the fair equivalent of an ownership of a kind that should be taxed.

But Section 166, as construed by the Court below, lays a tax, not on an equivalent of ownership, but on the equivalent of abandonment.

Mrs. Dunning was the owner of an equitable interest in the corpus. She could have compelled the performance of the trust's undertakings. If she had assigned that interest, the assignee would have paid the income tax (*Blair v. Commr.*, 300 U. S. 5, 13). And it is ownership to which tax liability attaches (*Blair v. Commr.*, p. 12; *Hoeper v. Wisconsin*, 284 U. S. 206). Dunning could no more have claimed this income than if he had given or leased a farm to his wife, and had later tried to claim the crops himself during the term of the gift or lease. (*Helvering v. Horst*, 85 L. ed. 99, 103). It is plain that where a settlor at every moment retains the power to repossess the corpus he has such a measure of control as justifies the legislative imposition on him as the person having the actual command over the property taxed (*Reinecke v. Smith*, 289 U. S. 172, 177).

Section 166, as construed by the majority of the lower Court, is arbitrary. The lawmakers have located the

equivalent of ownership, or a similitude of ownership, where there was no ownership at all. They have imposed a "burden unrelated to privilege or benefit," within the distinction drawn in *Burnet v. Wells* (p. 679).

Strangely enough, the lower Court italicizes this passage from a Tax Magazine Article,

> "A term running for one or two years, subject to a future power of revocation, seems to be sufficiently within the grantor's control for taxation purposes. But where this term extends beyond four or five years, the alleged power or control seems to shrivel away. Taxation based upon such distant future right would appear violative of the Fifth Amendment." (R. 75)

It cannot be disputed that a statute which imposes a tax upon an assumption of fact which the taxpayer is forbidden to controvert is so arbitrary and unreasonable as to cause it to fall before the due process of law clause of the Fifth Amendment.

> *Heiner v. Donnan*, 285 U. S. 312, 325, 326.
> *Hoeper v. Wisconsin*, (supra).

But, it is submitted, Section 166, as shown by its legislative history, and by a reasonable reading of the language used, was never designed to be so narrowly or so literally understood, as it is expounded by a majority of the Court below. Considered either from the technical or from the substantial point of view, the statute should be construed to have a meaning within constitutional and historical bounds. That reasonable interpretation is this:

> If a trust be irrevocable, then, as long as it is irrevocable, the income tax is to be paid by the equitable owner. In the year when the trust is

> revoked (in this case, 1937), by notice given shortly before the year when the revocation is effective, then the donor's control, or command of benefits is reasserted, and the tax burden is thereafter his.

Putting the matter in a somewhat different way, it comes to this. The Supreme Court in *Helvering v. Wood* had to decide whether the difference between a reverter and a power to revest was too fine and technical a distinction to be considered in construing a tax law. The earlier case of *Helvering v. Hallock*, 309 U. S. 106, indicated that income tax laws were not to be restricted by technical common law rules in regard to estates. The Supreme Court was, therefore, confronted with the question as to whether or not the distinction above mentioned was too fine and technical for a tax case. They held that it was not. That on the contrary it was a distinction which, in view of the language of the Act of Congress and the discussion of the proposed Act while in Congress, was not too technical to be applied in construing a tax law, but on the contrary was one which should be heeded. As stated by this Court, the matter is presented as follows:

> "Whether as a matter of policy such nice distinctions should be perpetuated in a tax law by selecting one type of trust but not the other for special treatment is not for us. We have only the responsibility of carrying out the Congressional mandate. And where Congress has drawn a distinction, however nice, it is not proper for us to obliterate it. That seems to us to be the case here."

As we see it, Judge Dobie does not agree with the above statement, but on the contrary he thinks that the distinction should be obliterated and proceeds to do it in the following language:

> "In apparent opposition to the spirit of the earlier decision of *Helvering v. Hallock,* the decision in the Wood case was based upon fine technicalities. The Court went to great extremes and split many hairs to hold that a grantor's reversionary interest in a five-year term trust did not come within the terminology of Section 166."

This can only mean that in the opinion of Judge Dobie the decision in *Helvering v. Wood* was a wrong decision, the result of splitting many hairs, and he does not propose to follow it. Surely in so doing he has clearly gone beyond the powers of the lower Court.

Respectfully submitted,

VERNON COOK,

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